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PSC ISSUES FINDINGS IN LG&E/KU COAL PURCHASE REVIEW

FRANKFORT, Ky. (March 5, 2004) – The Kentucky Public Service Commission (PSC) today released the findings of an audit, containing 15 recommendations highlighting areas of improvement for the fuel purchasing and fuel management practices of Kentucky Utilities Company (KU) and Louisville Gas and Electric Company (LG&E) and LG&E Energy LLC (LG&E Energy). KU and LG&E are wholly owned subsidiaries of LG&E Energy.

The recommendations suggest several areas that could be improved. They include enhancing existing policies, operating procedures, and job descriptions; potential further separation of regulated and non-regulated affiliates; and enhancing the Fuels Department's handling and communication of information. The report also includes 42 findings made by the auditors. Key findings are listed on the accompanying fact sheet.

The audit stems from the PSC's review of KU's July 2001 purchase of 102,000 tons of Polish coal. In January 2003, the PSC ruled, in Case No. 2000-00497B, that the purchase imposed unreasonable costs on KU's ratepayers. KU was ordered to refund a total of $673,000 to its customers.
The commission also ordered an independent focused management audit of the fuel purchasing and management practices of KU and its sister and parent companies. The Liberty Consulting Group, an independent consulting firm headquartered in Quentin, Pa., performed the audit.

Liberty Consulting examined five primary aspects of the companies fuel acquisition and management: organization, staffing and controls; fuels planning; fuels acquisition; supply management; and affiliate relations. KU and LG&E received generally high marks in most areas of fuel procurement and management.

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KU and LG&E will be required to develop action plans to address the recommendations contained in the audit report. KU and LG&E will also be required to file reports detailing the actions taken to comply with the audit recommendations. The reports must be filed with the PSC every six months for the next two years.

The PSC routinely reviews coal purchases by regulated utilities. The reviews monitor how electric utility companies are applying the fuel adjustment clause. The fuel adjustment clause is governed by a regulation that permits utilities to adjust their electric rates to reflect fluctuations in the price of coal burned to generate electricity.

KU, which operates in Kentucky and Virginia, generates, transmits and distributes electricity for retail and wholesale sale. KU has about 477,217 customers in 77 Kentucky counties. LG&E, a public utility, generates, transmits and distributes electricity and distributes natural gas. LG&E has about 385,000 electricity customers in nine Kentucky counties.

The final audit report and related audit documents are available on the PSC Web site at: http://psc.ky.gov/agencies/psc/hot_list/m_audit/ku_lge.htm

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FACT SHEET

Focused Management Audit of Fuel Purchasing and Management Practices of LG&E and KU - Key Findings

- Fuels Department personnel have solid skills and sound experience in the coal area.
- Fuel Procurement policies and procedures are too general and omit certain aspects of fuel procurement and management.
- Necessary procedures related to fuel management dealings with the non-regulated affiliate, Western Kentucky Energy (WKE), do not exist.
- There is a sound process for analysis of coal bids and approval of coal procurement recommendations.
- The Fuels Department has been effective integrating its fuel plans with corporate plans and in balancing risk and supply options.
- There is a reasonable process for vendor selection and identifying acquisition needs.
- While thorough and consistently followed, the coal procurement evaluation process must be improved.
- There is a satisfactory process for negotiating and renegotiating contracts.
- The Fuels Department administers coal contracts in a satisfactory manner and has an effective process for monitoring supplier performance.
- While currently accurate, the handling of information on coal weights can be more efficient.
- Coal inventory is handled in a satisfactory manner. However, there are a number of instances where there are considerable and consistent variances between the amount of coal in inventory as measured through physical surveys and the amount of coal carried on the books of the company.
- The Fuels Department is properly interpreting the requirements for its monthly fuel adjustment clause filings and is submitting these filings in accordance with the applicable regulations.
- LG&E Energy hasn’t sufficiently separated the procurement functions for LG&E/KU and WKE.

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